

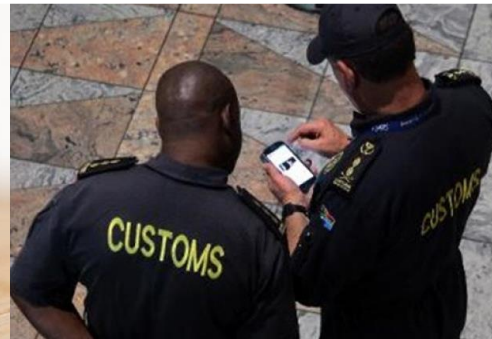


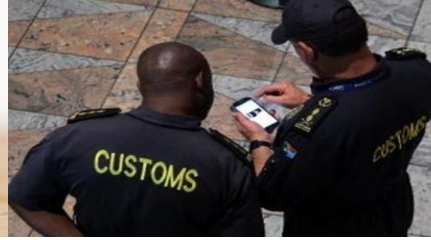
THE TOBACCO INSTITUTE OF SOUTHERN AFRICA

INTRODUCTION

#IllicitTobaccoSA

5 July 2018

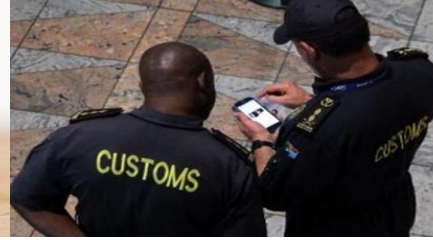




DISCLAIMER

Figures and statistics referred to in this presentation, represent an industry view based on external research and publicly available market information. The definition of “illicit trade” for purposes of this document includes any product sold to consumers below R17,85, and/or being non-compliant to the Tobacco Products Control Act, No 83 of 1993 (as amended). The various brands referred to herein are assumed to be manufactured and /or distributed by the corporate entities who publicly claim to do so. TISA accepts no responsibility or liability whatsoever with regard to the information or statistics quoted incorrectly or out of context from this presentation by any person.

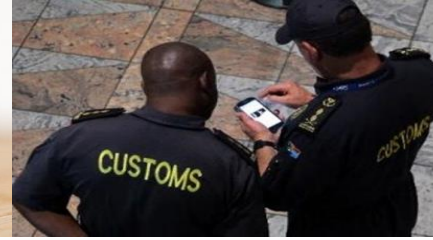




TISA SCOPE & MANDATE

- TISA is the industry body for the legal tobacco sector in SA; mandate extends into the Southern African Customs Union (SACU) region.
- TISA represents farmers, leaf processors, leaf merchants, manufacturers, importers and exporters of all tobacco products; in the legally compliant industry. *Clear distinction between legal and illegal industry*
- Strategic objectives:
 - Regulation (secure a reasonable regulatory framework for the sector)
 - Illicit Trade (strategy to bring down illicit rates in cooperation with Govt)
 - To ensure the sustainability of tobacco sector, including farmers.
- TISA believes in public/private partnerships to achieve objectives for the Govt (NDP), the sector and SA pty ltd, on the basis of trust, mutual respect and good relationships.





Illicit Trade - Understanding the Problem: Counterfeit, non-compliant, Duty not Paid

Is the product compliant with National Health Regulations?

HOW TO SPOT ILLEGAL CIGARETTES

- PRICE**
As of March 2014, a retail price to the consumer of less than R16.50 per pack could indicate that excise and VAT has not been paid (Contravenes the Customs and Excise Act)
- SA DIAMOND STAMP**
Absence of the SA Diamond stamp, which could be positioned anywhere on the pack, but is normally positioned at the bottom of the pack (Contravenes the Customs and Excise Act)
- HEALTH WARNING**
Absence of / incorrect health warnings (Contravenes the Tobacco Products Control Act)
- QUIT LINE NUMBER**
Absence of quitline number or incorrect quitline number (Contravenes the Tobacco Products Control Act)
- TAR / NICOTINE READING**
Readings on the pack are higher than 12 mg Tar and / or 1.2 mg Nicotine (Contravenes the Tobacco Products Control Act)
- 'REDUCED IGNITION PROPENSITY' MARKING**
Absence of the 'Reduced Ignition Propensity' marking on the pack (Contravenes the Tobacco Products Control Act - Regulation No. R1429 Relating to the Standards for Manufacturing of Reduced Ignition Propensity Cigarettes)

Yes

R 17-85/20

Is the product sold below the MCT (minimum collectable tax)

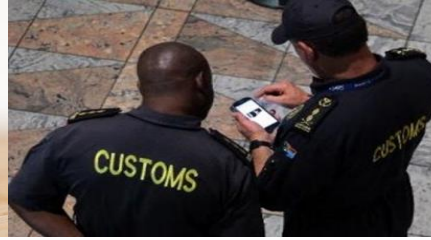


No

ILLEGAL TRADE

Yes, requires investigation





Legal precedent

- A 2015 judgment in the Eastern Cape High Court found that tobacco products selling below the tax owed must be illicit.
- In that matter, relating to sales of Gold Leaf Tobacco Company's Savannah brand for R8 a pack, a price well below the tax owed to SARS, the judge found: "The logical inference to be drawn is that no excise duty was paid in respect of the cigarettes in question."



IPSOS: THE 2018 NATIONAL TOBACCO MARKET STUDY

#IllicitTobaccoSA

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What is the market
for cigarettes sold
below the tax
owed on each
sale?

What are the
brands retailing
below tax owed?

The Tobacco Institute of Southern Africa (TISA) commissioned IPSOS to research:

- How many cigarettes sold below the minimum collectible tax (R17.85 per pack) owed on each sale?
- **Who is selling them?**
- **All cigarette brands included**

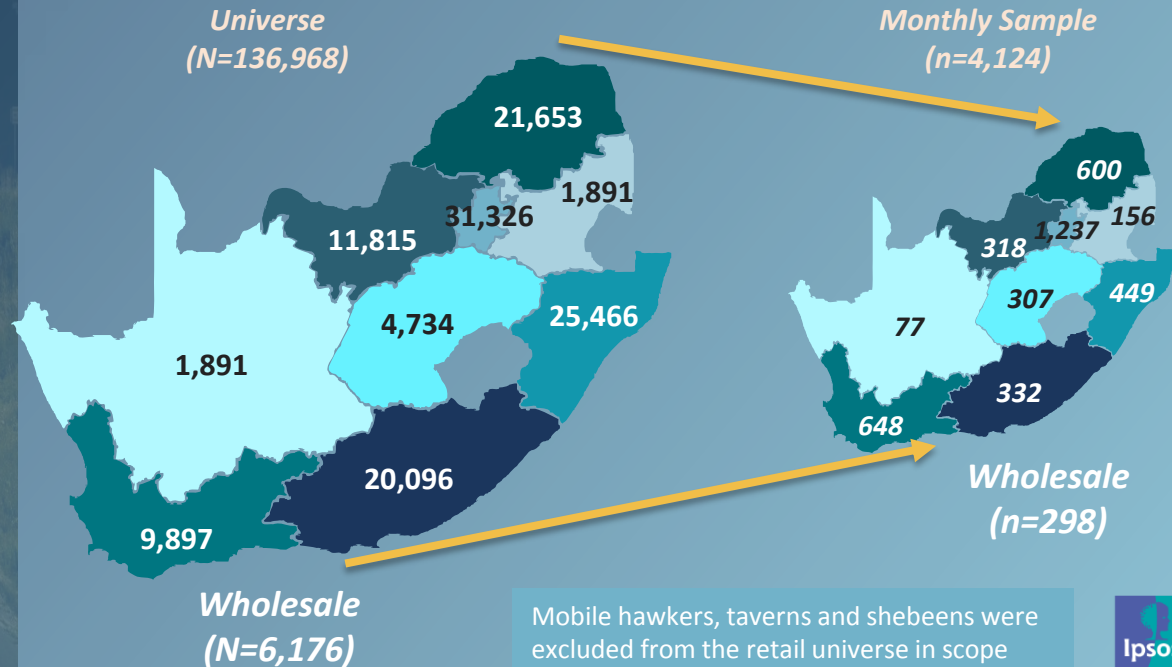
TISA assumes that brands selling below the tax owed price have not paid all taxes to SARS and are illicit

- This research estimates volume of sales at prices below minimum tax owed per pack only...
- And likely underestimates illicit trade

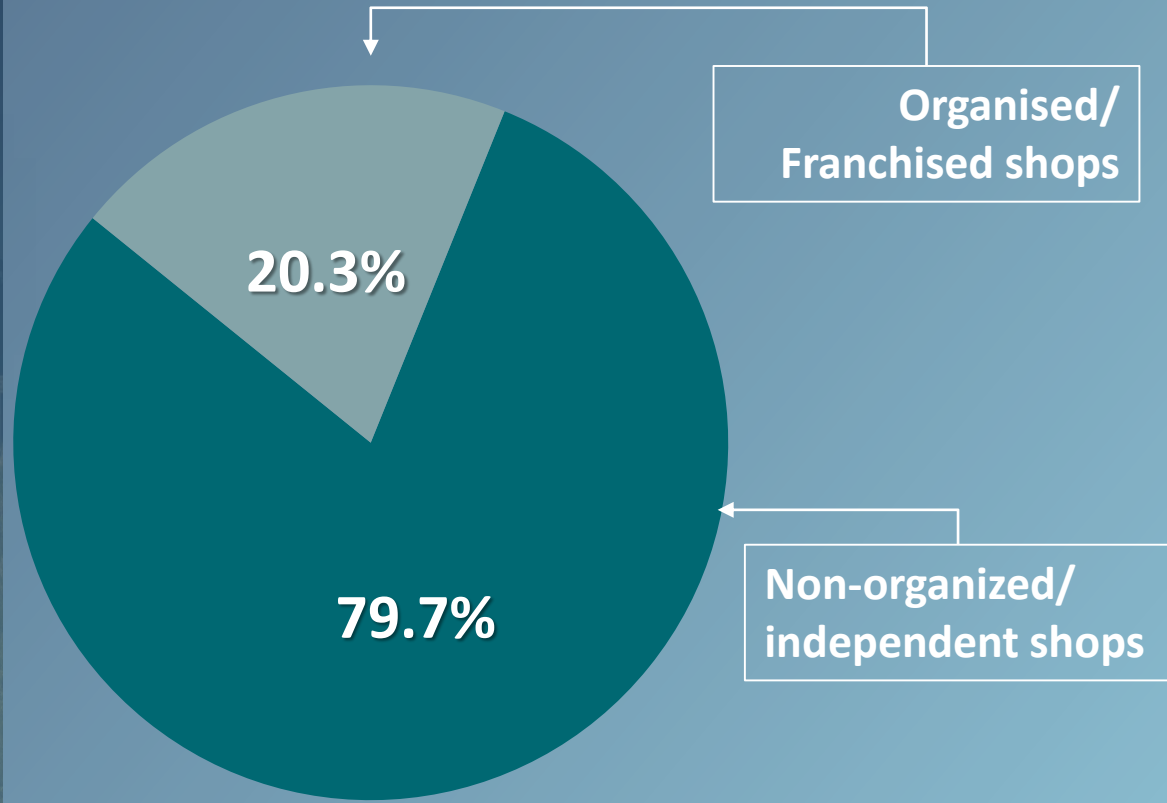
Retail census was done to estimate **size** of the tobacco retail universe

This was followed by a **retail audit** (4,124 shop visits in total)

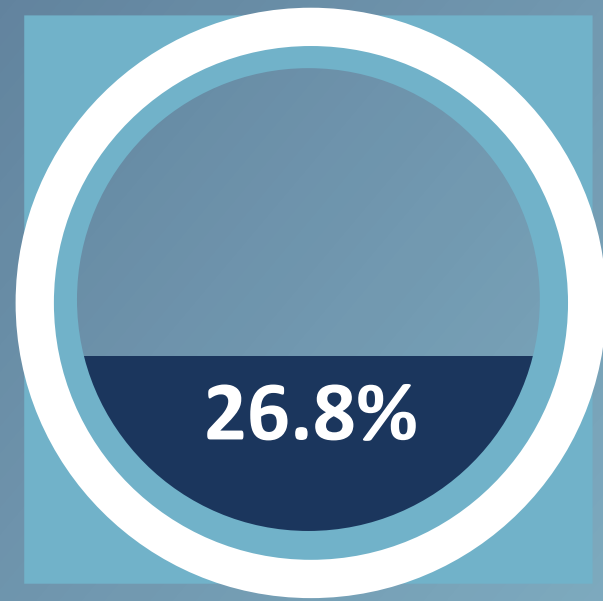
- A representative sample of the retail universe was audited for sales below minimum tax owed
- Research methodology has been peer reviewed



The **non-organised trade** sells **79.7%** of all cigarettes sold in South Africa



Brands retailing **below tax owed, make up 26.8 %** of sales in Total South Africa retail.



Share of below tax owed in South Africa

- Below tax prices did not feature significantly in organised trade

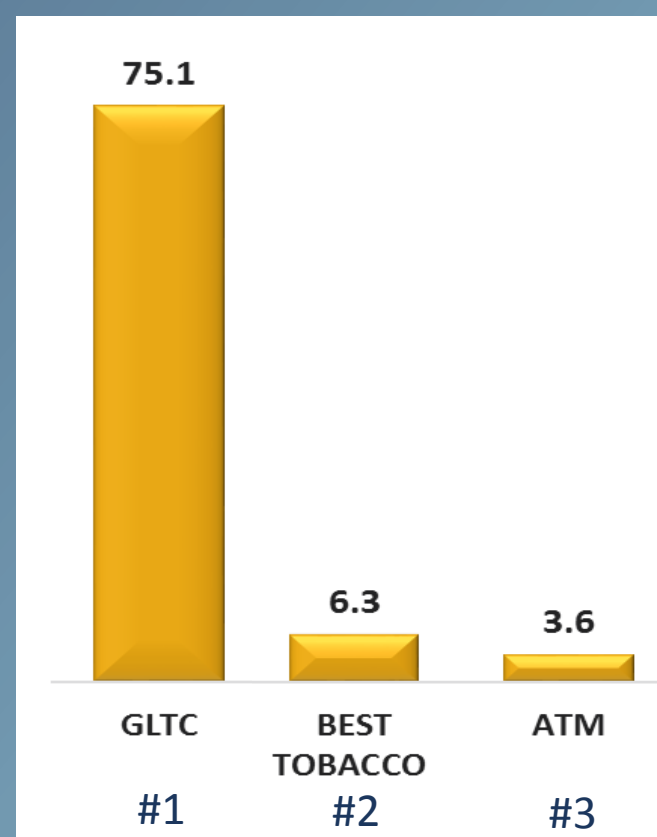
Brands retailing below tax owed are found in **three out of every four** non-organised shops

±100,000 stores



33.4 % of Cigarettes sold in non-organized trade are retailing below tax owed

Brands from Gold Leaf Tobacco Company (GLTC) make up **75.1%** of all sales below minimum tax owed on each sale



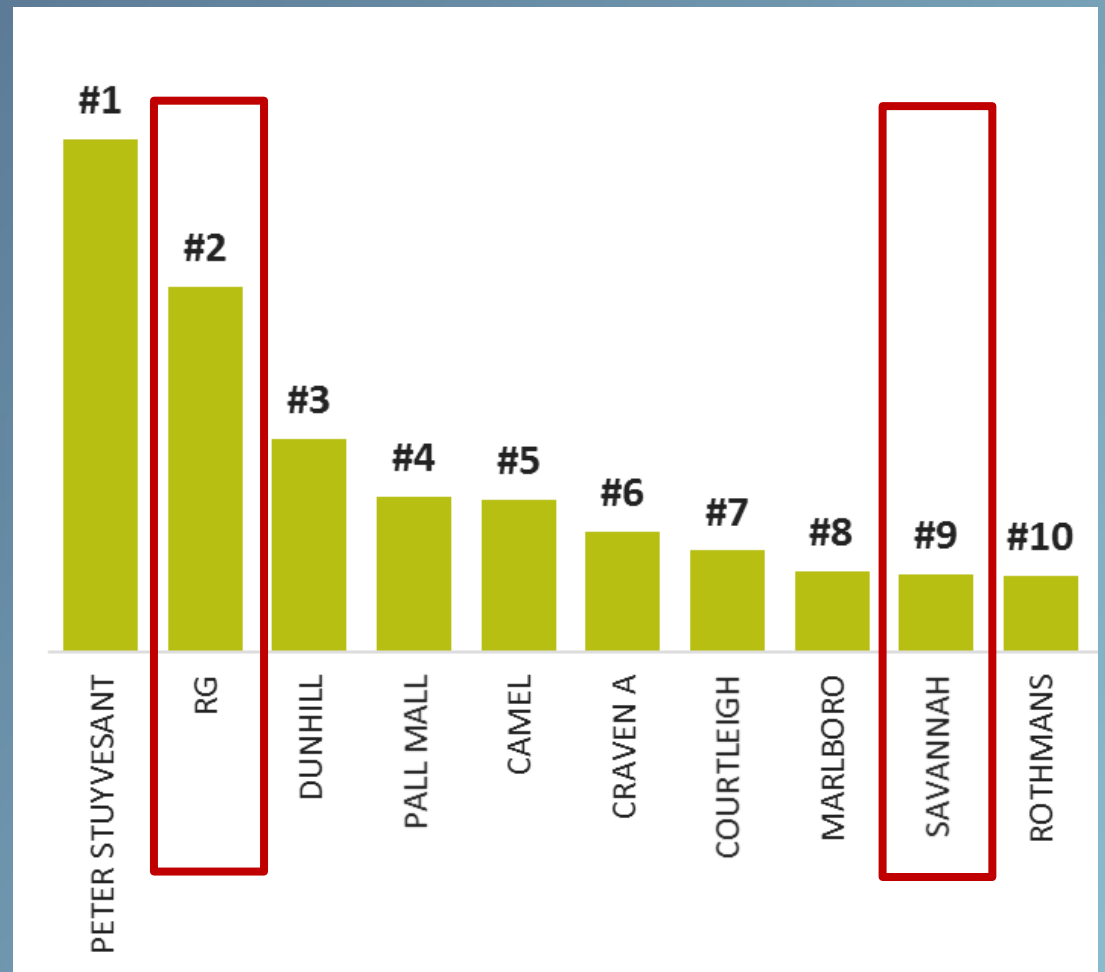
Top 3 Manufacturers selling below minimum tax owed

Below tax brands can sell for as little as R5 per pack and are generally priced around R10 (minimum collectible tax is R17.85)...

#	Manufacturer/ Brand owner	Brand	Share of market	Average price
1	GLTC	RG	50.5	R10.50
2	GLTC	SAVANNAH	8.9	R13.10
3	BEST TOBACCO	CAESAR	6.3	R10.20
4	GLTC	SHARP	6.3	R11.90
5	GLTC	CHICAGO	5.8	R12.00
6	GLTC	SAHAWI	2.5	R10.60
7	SAVANAH (ZIM)	PACIFIC	2.3	R10.60
8	MASTERMIND TOB	YES	2.2	R10.40
9	Carnilinx	JFK	2.2	R10.40
10	ATM	CK	1.7	R11.80

...80% of sales is in single sticks typically at 50c per stick

RG (from GLTC) is the **top selling brand** below minimum tax owed; and is now the **2nd largest brand overall**.



Conclusions

- There is a sizeable market for brands sold at prices below the tax owed to SARS
- These brands are very well established in the non-organised retail, are present in 3 out of 4 shops
- This market is overwhelmingly dominated by one local company – Gold Leaf Tobacco Company
- These brands sell consistently and significantly below the tax owed price.
- Their sales above tax owed price are generally negligible

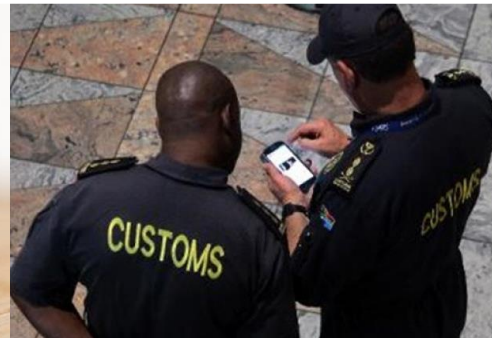
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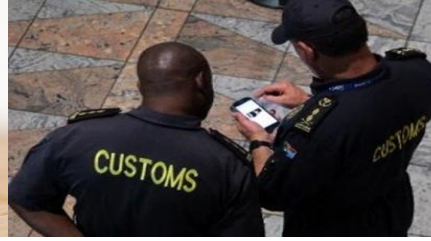


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WHAT THE IPSOS FINDINGS MEAN FOR SOUTH AFRICA

#IllicitTobaccoSA

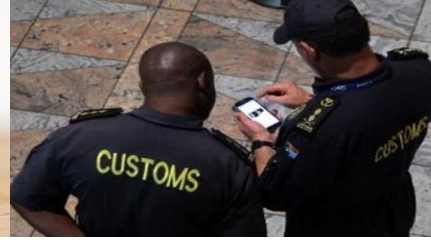




THE VALUE AT STAKE

- In 2014, TISA Members stimulated economy-wide production amounting to more than **R54.3 billion**
 - **108,475** jobs in SA
 - **R22.4 billion** in government tax revenue
 - Exports worth **R2.6 billion** annually
- **8,000 - 10,000** jobs in the agricultural sector alone – **186** commercial and **155** emerging farmers
- Returns of more than **R640 million** annually for legal tobacco farmers





WORKING RELATIONSHIP WITH SARS

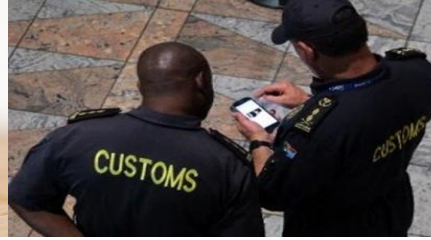
PRE-2014:

- SARS and TISA had effective working relationship since 2005
- SARS referred to TISA co-operation as a model of public/private partnership

2014-2017

- SARS crippled, project “Honeybadger” terminated in 2014, no investigations
- Breakdown of action and co-operation from SARS
- Created opportunity for illicit operators to flourish



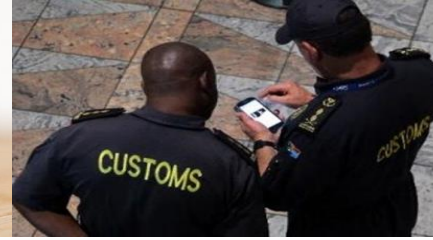


THE IPSOS FINDINGS: KEY TAKEOUTS

Cheapest first smoke in the world, available in over 100,000 shops






- The illicit market has now hit epidemic proportions
 - It is sold in **3 out of 4 shops of the non-organised retail - over 100,000 shops**
 - It is available at **prices as low as R5**. The minimum tax owed on a pack – just on its own – is R17.85
- At least 8 billion sticks are illicit - thus **SARS is losing over R7 billion this year.**
- **14%** of estimated Government shortfall of **R50 billion**



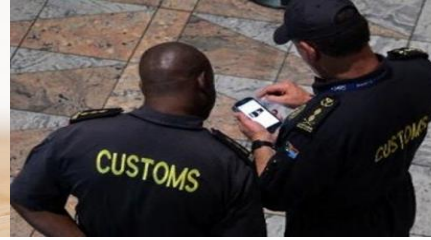


THE IPSOS FINDINGS: KEY TAKEOUTS

75% of illicit is from one manufacturer in a local factory licensed by SARS

	Top Five Illicit Brands	Share of Illicit	Manufacturer
1	RG (second biggest brand in market overall) 	50.5%	GLTC
2	SAVANNAH 	8.9%	GLTC
3	CAESAR 	6.3%	BEST TOBACCO
4	SHARP 	6.3%	GLTC
5	CHICAGO 	5.8%	GLTC





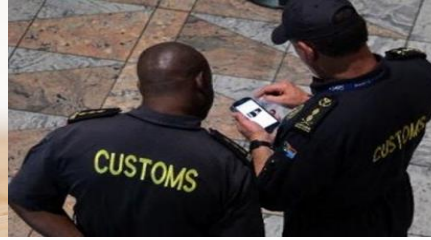
THE IPSOS FINDINGS: KEY TAKEOUTS

Illicit traders have cashed in on the demise of SARS

- We estimate that illicit traders could have made over **R15 billion** in the last 3 years
- Legal industry volumes dropped **15%** since 2015
- Last week, former Chief Enforcement Officer, Gene Ravele, told the SARS Inquiry:

“After I left [2015], there was no inspections at cigarette factories. Until today. When the Minister of Finance complains of the lack of compliance, it was planned....If you are going to stop inspections, people are going to do as they wish.”





ASIDE FROM THE FINANCIAL IMPACT....

Social Impact: Impact on health and impact on livelihoods

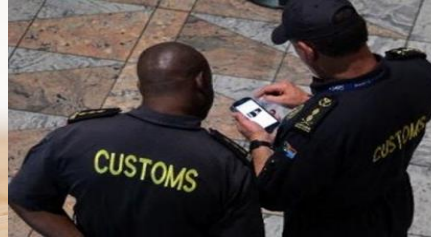
Compromises the government's health agenda:

- Market flooded with cheapest first smokes in the world
- Available and affordable to children and the vulnerable.

Threat to jobs, especially in deep rural areas:

- **8000 - 10,000** tobacco farm workers with **30,000 to 35,000** dependents
- **155** emerging tobacco farmers planting tobacco and food crops, promoting food security



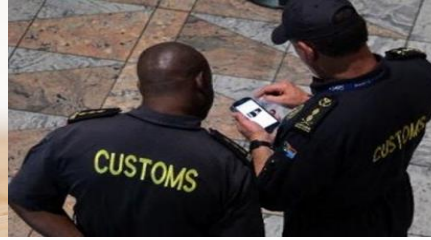


ASIDE FROM THE FINANCIAL IMPACT....

Hurts South Africa's attractiveness to foreign investors

- Tax-evading companies permitted to operate with impunity
- Trust in fair tax administration and the rule of law a prerequisite for investment
- SA can ill afford to scare off investors and job creators
- Organised crime: Interpol found illicit cigarette trade funds other criminal activities and fuels corruption.





WHAT'S TO BE DONE?

Urgent action is needed

Short term solutions can be effected quickly

- **Monitor production:** place customs officials in all cigarette manufacturing plants.
- **Ban on sales below the level of tax owed.**

TISA SUPPORTS INTENTIONS BY NEW SARS ACTING COMMISSIONER AND MINISTER OF FINANCE AND FULLY COMMITTED TO COOPERATE AND ASSIST IN ERADICATING ILLICIT TRADE AS MATTER OF URGENCY





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thank you!